VIRGINIA:

In the Supreme Court of Virginia held at the Supreme Court Building in the City of Richmond on Thursday the 26th day of May, 2022.

Present: Goodwyn, C.J., Powell, Kelsey, McCullough, and Chafin, JJ., and Koontz and Millette, S.JJ.

CNT NOVA, Inc., et al., Appellants,

Against Record Nos. 210287 and 210288
Circuit Court No. CL-2019-07953

Commodore Capital LLC, Appellee.

Upon appeals from a judgment rendered by the Circuit Court of Fairfax County.

CNT NOVA, Inc. ("CNT NOVA") and its attorney, J. Chapman Petersen ("Petersen"), appeal from a judgment of the Circuit Court of Fairfax County ("circuit court") awarding sanctions against them for filing a complaint against CNT NOVA's competitors[1] without making reasonable inquiry into the allegations. Upon consideration of the record, briefs, and argument of counsel, the Court is of opinion that there is reversible error in the judgment of the circuit court.

I.

On June 7, 2019, CNT NOVA filed its complaint against Commodore Capital LLC ("Commodore") for tortious interference with a contract, contractual expectancy, and business relationships. CNT NOVA alleged that in 2014 and 2015, CNT NOVA's CEO, Simon Gillett,

[1] Another competitor, In Loco Parentis ("ILP"), was also named as a defendant in CNT NOVA's complaint. CNT NOVA was granted a nonsuit as to ILP on January 15, 2020. ILP subsequently filed a motion for sanctions against CNT NOVA, which was denied by the circuit court. ILP failed to appeal the circuit court's decision. Therefore, any issues concerning ILP are not relevant to this appeal.

entered into franchise agreements with College Nannies & Tutors Development, Inc. ("CNT National"), under which CNT NOVA was granted the "right and non-exclusive license" to provide nanny, babysitting, homework, tutoring, and college preparation services in Loudoun County and northern Fairfax County. The agreements provided that CNT National would not operate another franchise under the CNT name within CNT NOVA's designated territories. At the time CNT NOVA obtained its franchises, it was the only franchisee in the Northern Virginia area.

CNT NOVA alleged that it generated revenues of $260,544 in 2014, $1,149,151 in 2015, and $1,764,461 in 2016. On March 28, 2017, CNT NOVA received a proposal to purchase CNT NOVA for $1,100,000, subject to there being "no material adverse change in the business, results of operations, prospects, conditions (financial or otherwise) or assets of [CNT NOVA]."

On October 11, 2017, Gillett was notified by CNT National that James Doody, the CEO of Commodore, executed franchise agreements to provide services in territories in Fairfax County, including central Fairfax County and Fairfax City, which bordered or were near CNT NOVA's territories. On October 18, 2017, Gillett met with Doody to discuss their future relationship, and Gillett put Commodore on notice of CNT NOVA's territory and expectation for continuing customer relationships.

In early 2018, Commodore obtained office space in the same Fairfax City office building that housed CNT NOVA, which led to a dispute between the two franchisees. Doody accused CNT NOVA of operating outside its territory by maintaining an office in a territory assigned to Commodore. However, CNT NOVA maintained that it did no marketing from its Fairfax City office. Doody brought to CNT National's attention that CNT NOVA was maintaining an office in a Commodore territory.

CNT NOVA alleged that Commodore achieved $550,000 in revenue for 2018, whereas CNT NOVA's monthly revenues dropped by over 70% from the year before without any changes to its business model or management. CNT NOVA alleged in its complaint that Commodore began using the CNT name and its access to CNT National's customer database for "marketing to" and "servicing of" CNT NOVA's clients. CNT NOVA claimed that Commodore's intentional violations of CNT NOVA's "exclusive rights" under its franchise agreements caused CNT NOVA to lose clients and business, ultimately resulting in CNT NOVA selling its assets and franchise interests for only $300,000. CNT NOVA only received $150,000 in the sale due to the continued decline in business. In its complaint, CNT NOVA sought $1,000,000 in compensatory damages and $350,000 in punitive damages.

In July 2019, Commodore demurred, contending that there was "no reasonable and cognizable contract expectancy with any of the clients in [CNT] NOVA's territory which raises to the level of required expectancy to satisfy that element of tortious interference with business expectancy." Commodore further argued that "both [CNT NOVA] Franchise Agreements clearly state that the franchise rights granted by CNT [National] are non-exclusive licenses," meaning that competitors were only precluded from marketing to, not serving, clients in another franchisee's territory. On August 30, 2019, the circuit court overruled Commodore's demurrer.

On September 20, 2019, Commodore filed a counterclaim against CNT NOVA, specifically alleging that CNT NOVA interfered with Commodore's franchise expectations by maintaining an office in the same building as Commodore and in Commodore's territory, as well as engaging in marketing activities in Commodore's territory. Commodore sought $450,000 in compensatory damages and $350,000 in punitive damages. Commodore replaced its first counsel soon after filing its counterclaim.

A jury trial was set for May 4, 2020. On October 2, 2019, Commodore responded to a written discovery request from CNT NOVA, revealing relevant customer data through CNT National, identifying the source of all 2018 customers serviced by Commodore and CNT NOVA as well as whether the customers were within the assigned territory of another franchisee. The information uncovered the fact that a national call center, the Back-Up Care program ("BUCA"), had been responsible for directing the vast majority of customer calls originating in CNT NOVA's territory to Commodore. Because this information was proprietary to CNT National and CNT NOVA was no longer a franchisee, CNT NOVA claimed it had no means by which it could have discovered this information before filing suit against Commodore.

In December 2019, Petersen discussed a potential mutual nonsuit with Commodore's second counsel, John Keith. After consulting with his client, Keith responded that Commodore refused to agree to a mutual nonsuit. Its consent was required under Code § 8.01-380(D)[2] due to Commodore's counterclaim. Discovery closed in April 2020, but the jury trial date was continued to September 2020 because of concerns related to the COVID-19 pandemic.

Following the recusal of all Fairfax judges on May 19, 2020, this Court appointed Retired Judge Joseph J. Ellis to preside over the remainder of the proceedings. In June 2020, over Commodore's adamant objection, the circuit court granted Keith's motion to withdraw as Commodore's counsel due to a disagreement over the course of action Commodore wanted to take in the litigation. In July 2020, Commodore hired its third and current counsel, Michael Charnoff.

[2] Code § 8.01-380(D) states, "[a] party shall not be allowed to nonsuit a cause of action, without the consent of the adverse party who has filed a counterclaim . . . which arises out of the same transaction or occurrence as the claim of the party desiring to nonsuit unless the counterclaim . . . can remain pending for independent adjudication by the court."

On August 31, 2020, CNT NOVA filed its witness and exhibit list pursuant to the scheduling order. The following day, Commodore filed a motion to continue the trial date and reopen discovery for the purpose of deposing Gillett. Over CNT NOVA's objection, the circuit court granted Commodore's motion, set a bench trial for December 2020, and reopened discovery.

On October 29, 2020, the parties took depositions of Gillett and Doody. Gillett stated in his deposition that at the time of his initial meeting with Petersen, he had "secondhand reports from [CNT NOVA] managers that marketing took place" in CNT NOVA territories. Gillett further testified that Maxine Gill, the owner of another CNT National franchise, was a witness to Commodore's solicitation of CNT NOVA clients. Based on the contention that Doody conceded in his deposition that the respective claims of CNT NOVA and Commodore arose from a separate transaction and occurrence, CNT NOVA sought to nonsuit its own claim, thus, avoiding the requirements of Code § 8.01-380, and made a motion for summary judgment against Commodore's counterclaim. Commodore opposed the nonsuit.

Three weeks prior to the December 2020 trial date, Commodore agreed to a mutual nonsuit. The parties each sought to retain the December 2020 trial date for the limited purpose of a hearing on their cross motions for sanctions. The circuit court granted the mutual nonsuit but retained jurisdiction for the sanctions hearings by suspending the order.

On December 15, 2020, the circuit court heard argument on the cross motions for sanctions. The circuit court ultimately denied CNT NOVA's motion for sanctions and granted Commodore's motion, which is the ruling at issue in this appeal.[3] The circuit court specifically

[3] CNT NOVA does not appeal the circuit court's decision denying its motion for sanctions.

noted that there was deposition testimony available that clearly established that the allegations in CNT NOVA's complaint were speculative. The circuit court further noted that the lawsuit amounted to a "fishing expedition." The circuit court went on to state that "[s]omebody had to be blamed [for the decline in CNT NOVA's business] and you're going to start with the other franchisees." The circuit court concluded that CNT NOVA had made "no reasonable inquiry of any significant type." The circuit court entered an order granting Commodore's motion and awarding $54,056.15 in sanctions against CNT NOVA and Petersen, jointly and severally. This appeal followed.

II.

On appeal, CNT NOVA and Petersen contend that the circuit court abused its discretion in awarding sanctions against them.

The imposition of sanctions is controlled by Code § 8.01-271.1, which states in pertinent part:

> The signature of an attorney or party constitutes a certificate by him that (i) he has read the pleading, motion, or other paper, (ii) to the best of his knowledge, information and belief, formed after reasonable inquiry, it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and (iii) it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.
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> If a pleading, motion, or other paper is signed or made in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed the paper or made the motion, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper or making of the motion, including reasonable attorney fees.

Code § 8.01-271.1(B) & (D). "In reviewing a trial court's decision to impose a sanction pursuant to Code § 8.01-271.1, we apply an abuse of discretion standard." *Kambis v. Considine*, 290 Va. 460, 466 (2015) (quoting *Shebelskie v. Brown*, 287 Va. 18, 26 (2014)).

> In applying [an abuse of discretion] standard, we use an objective standard of reasonableness in determining whether a litigant and his attorney, after reasonable inquiry, could have formed a reasonable belief that the pleading was well grounded in fact, warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and not interposed for an improper purpose.

Flippo v. CSC Assocs. III, L.L.C., 262 Va. 48, 65-66 (2001). Any doubts should be resolved in favor of the counsel filing the pleading. *Tullidge v. Board of Supervisors*, 239 Va. 611, 614 (1990).

"The reason for applying [an abuse of discretion] standard is that we are usually confronted with a mixed question of law and fact" because

> clause (ii) of the second paragraph of Code § 8.01-271.1 provides that an attorney's signature to a pleading has a two-pronged effect: [1] the attorney certifies that the pleading is well-grounded in fact, to the best of his knowledge, and also [2] that it is warranted by law, or a good faith argument for a change in the law.

Ford Motor Co. v. Benitez, 273 Va. 242, 249-50 (2007). As there is no question that CNT NOVA's claims were based on valid principles of existing law, the second prong of clause (ii) is not at issue in this case. "[T]his appeal turns upon a single issue: was the pleading well grounded in fact to the best of the knowledge, information, and belief of the attorney who signed it, formed after reasonable inquiry?" *Id*. at 250-51.

"'[T]he wisdom of hindsight should be avoided' in applying the appropriate objectively reasonable standard of review." *Gilmore v. Finn*, 259 Va. 448, 467 (2000) (quoting *Tullidge*, 239 Va. at 614). The "temporal focus of [Code § 8.01-271.1] is the time an action is filed."

Meuse v. Henry, 296 Va. 164, 189 (2018). The factfinder may "properly consider any relevant and admissible evidence tending to show the attorney's state of knowledge at the time in question." *Ford Motor Co.*, 273 Va. at 251.

The circuit court granted sanctions against CNT NOVA and Petersen on the grounds that CNT NOVA and its counsel failed to perform a reasonable inquiry before filing suit. The circuit court relied heavily on Gillett's deposition, which recounted the information possessed by CNT NOVA and Petersen at the time of the filing of the complaint. The circuit court stated that the deposition established that CNT NOVA's complaint constituted a "fishing expedition," and "there was no reasonable inquiry of any significant type." We conclude, however, that based on the information available to Petersen at the time he filed the complaint in June 2019, there was sufficient evidence to support a claim for tortious interference with a contract based on Commodore's conduct. *See Dunlap v. Cottman Transmission Sys., LLC*, 287 Va. 207, 216 (2014). In fact, CNT NOVA's complaint survived Commodore's demurrer.

To support a claim of tortious interference, a claimant must show

> (1) the existence of a valid contractual relationship or business expectancy; (2) knowledge of the relationship or expectancy on the part of the interferor; (3) intentional interference inducing or causing a breach or termination of the relationship or expectancy; and (4) resultant damage to the party whose relationship or expectancy has been disrupted.

Id. (quoting *Chaves v. Johnson*, 230 Va. 112, 120 (1985)). Before Petersen signed and filed the complaint on June 7, 2019, he met with his client on May 15, 2019, and reviewed the franchise agreements. CNT NOVA believed, and conveyed to Petersen, that CNT NOVA's business suffered a drastic decline, with monthly revenues dropping by over 70%, soon after Commodore obtained franchises from CNT National in areas close to CNT NOVA's territories. CNT NOVA and Commodore developed an adversarial relationship. Gillett indicated in his deposition that at

the time of his initial meeting with Petersen, he had "secondhand reports from [CNT NOVA] managers that marketing took place" in CNT NOVA territories. Gillett also indicated that the owner of another CNT National franchise witnessed Commodore's solicitation of CNT NOVA clients. Earlier in 2019, CNT NOVA had sold its two franchises at a significant loss compared to offers made before the decline in business. Notably, neither CNT NOVA nor Petersen had access to the confidential and proprietary sales and customer data possessed by CNT National.

Because CNT NOVA and Petersen possessed sufficient evidence to support a claim for tortious interference upon filing the complaint in June 2019, we find that the circuit court abused its discretion in finding that CNT NOVA and Petersen violated Code § 8.01-271.1.

CNT NOVA and Petersen next contend that the circuit court abused its discretion by awarding fees to Commodore for expenses incurred by its own conduct. This Court's opinion in *Oxenham v. Johnson*, 241 Va. 281 (1991), is particularly instructive here. In *Oxenham*, the trial court awarded sanctions against a plaintiff's attorney for violations of Code § 8.01-271.1 arising from a malicious prosecution claim brought against a Department of Social Services licensing inspector. *Id*. at 284-85. During litigation, it became apparent that the charging decision at issue was made by the licensing administrator instead of the licensing inspector. *Id*. Nevertheless, the plaintiff continued with the malicious prosecution claim, asserting a claim for punitive damages against the licensing inspector. *Id*. After a jury verdict for the defense, the licensing inspector filed a motion for sanctions against the plaintiff. *Id*. The trial court awarded sanctions, finding that the plaintiff failed to conduct a reasonable investigation and the purpose for filing the action was "to harass the defendant." *Id*. at 286. On appeal, this Court emphasized that if the plaintiff "had filed any paper or made any motion in the case *after* he knew, or reasonably should have known, that he could not create a factual issue of [the licensing inspector's] involvement and

malice, the [trial] court would have been justified in imposing sanctions against him." *Id*. at 288. This Court further found that the plaintiff's filing of the case was justified, but once the plaintiff learned there was no actual malice, the punitive damages claim against the licensing inspector should have ended. *Id*. at 289.

In the case before us, unlike the plaintiff in *Oxenham*, Petersen discussed a mutual nonsuit with John Keith, Commodore's second counsel in this matter, upon discovering that the BUCA national call center was responsible for directing a majority of customer calls originating in CNT NOVA's territory to Commodore. Commodore refused to agree to a mutual nonsuit, and the suit continued throughout 2020. After CNT NOVA filed a motion for summary judgment to dismiss Commodore's counterclaim, Commodore ultimately agreed to a mutual nonsuit that was entered on November 23, 2020.

Code § 8.01-271.1(B) dictates that sanctions can be awarded for actions that are taken to further "any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation." After Petersen first offered a mutual nonsuit in December 2019, any damages that Commodore may have sustained arose from its own actions and failure to mitigate the damages at issue. Therefore, to the extent that any portion of the $54,056.15 awarded to Commodore arose from the period after Petersen offered a mutual nonsuit, the circuit court abused its discretion.

III.

Because the circuit court erred in finding a violation of Code § 8.01-271.1, we reverse the circuit court's judgment as to sanctions and enter final judgment in favor of CNT NOVA, Inc. and J. Chapman Petersen.

This order shall be certified to the Circuit Court of Fairfax County.

A Copy,

Teste:

Clerk